



News

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FOR RELEASE:
March 11, 2003

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**FHFB CHAIRMAN JOHN T. KORSMO'S REMARKS
TO AMERICA'S COMMUNITY BANKERS
GOVERNMENT AFFAIRS CONFERENCE**

Thank you, Bill (Zuppe). Congratulations on your record year last year. Ladies and gentlemen, a story in the Spokane Business Journal just used the term "glittering" to describe the kind of year that Sterling Savings Bank had in 2002. You don't often hear bankers called "glittering," but I congratulate you and thank you for the introduction.

And thank you all for providing me with this opportunity to speak to America's Community Bankers on issues before the Federal Housing Finance Board. My very first speech as chairman of the Finance Board was to the Government Affairs Conference a year ago.

In the intervening 12 months, the Board and staff have made noteworthy progress in improving our safety-and-soundness oversight of the Federal Home Loan Bank System, our very reason for existing, and that's good news for all of you who are members. I will talk about some of the details in a moment or two.

But first let me say, I'm intrigued to be on the agenda right between Secretary Snow and Rosario Marin, the U.S. Treasurer. I feel as if I should be signing dollar bills.

I am sincerely pleased to be here after Secretary Snow. This was the first opportunity I have had to hear him.

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The Federal Housing Finance Board is an independent regulatory agency, so we have no direct relationship with Treasury, and Treasury has no authority over us.

But certainly our agencies talk, talk often, and I am always interested in Treasury's views on issues, particularly issues like enhanced disclosure for government-sponsored enterprises.

They're for it. So am I.

Disclosure, enhanced disclosure, is an issue that the Finance Board and the 12 Home Loan Banks have been working on a great deal over the past six months, and the issue has real significance for all of you here whose institutions are members of a Federal Home Loan Bank.

As you know, Treasury was involved in last year's discussions that resulted in the agreement by Fannie Mae and Freddie Mac to register their stock voluntarily with the SEC.

A few days after that agreement last July, Treasury Under Secretary Peter Fisher was on the Hill, testifying to the House Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises.

He spoke about, in his words, "the importance of providing investors with assurance as to the comparability, consistency and sufficiency of GSE financial disclosures."

And then, he clearly stated the Administration's position, and I'll quote: "The Administration believes that all GSEs should comply with the same corporate disclosure requirements of the Securities Exchange Act of 1934, as interpreted and applied by the Securities and Exchange Commission."

Fed Chairman Alan Greenspan also spoke about GSE disclosure recently in testimony to the Senate Banking Committee.

In response to a question from New Hampshire Senator John Sununu about SEC oversight for government-sponsored enterprise disclosures, Chairman Greenspan said:

"The SEC is already involved in the question of making judgments as to whether certain types of securities ought to be registered or not registered. ... These are legally private corporations and should be handled the way private corporations are handled."

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And just a few days earlier, prior to his confirmation, the new Securities and Exchange Commissioner, William Donaldson, responded to a question from another member of the same committee. Donaldson said, and again I'll quote:

"I support what I believe is the Commission's view and the view of the Administration that government-sponsored enterprises should be role models for disclosure. As such, I believe that they should comply with the 'gold standard' of disclosure - the disclosure requirements of the federal securities laws."

Now, as I mentioned earlier, I'm chairman of an independent regulatory agency. However much I respect them, Treasury or the SEC or Chairman Greenspan have no direct authority over the Federal Housing Finance Board. We set our own agenda.

But when they talk about GSEs and their responsibility to the public, they are right. I agree with them. I believe that the Federal Home Loan Banks should be role models and fully and freely disclose financial management information under the '34 Act.

I believe that's going to happen. And when it does, the enhanced disclosure the Banks provide will be good news for homebuyers, for taxpayers, and for you who belong to America's Community Bankers and are members of the Federal Home Loan Bank System.

As a regulator, my job is not to be a cheerleader, an advocate, for the System. But I can say, with confidence, that the Federal Home Loan Bank System is a great System. It provides a tremendous service.

The Banks are more comfortably capitalized than other GSEs. Their cooperative stock structure discourages excessive risk-taking. Their loans to member banks and thrifts are well collateralized. With each passing day, they become better supervised by a reinvigorated Finance Board.

Given that the System is so strong, you, as local bankers, should want the public to know all about it. The greater the knowledge, the greater the demand for the System's products in the capital markets, the better the rates obtained by the System, and the lower the cost of money that you borrow in the form of advances. And, as Bankers, I know you want to borrow as inexpensively as you can.

Many have raised objections to SEC registration, of course, and I recognize that they raise these objections in good faith. Some have asked, "Why should anyone care about the Federal Home Loan Bank stock? It is cooperative stock, and no one trades it publicly."

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Well, many of you in this audience care, I am certain, precisely because you are members of the System and want to know all you can about the institution in which you have invested. Just as importantly, you want to know about the activities and finances of other Federal Home Loan Banks, the ones of which you are not a member, but for whose obligations your Federal Home Loan Bank is jointly and severally liable.

But the question is still a good one. And those who ask it are right. The general public does not worry about Federal Home Loan Bank stock.

But that misses an important point – a \$5 trillion point. The system borrowed some \$5 trillion last year – admittedly, most of it overnight, but \$600 billion at any given moment, and a large chunk of change, nonetheless – debt purchased by somebody, and those somebodies, the individuals and institutions who were the buyers of those obligations, have an intense interest – a financial self-interest – in knowing all they can about the System and the quality of its debt. And taxpayers or those who represent them have an intense interest in knowing whether the System can back up that debt.

Free markets have long demonstrated that superior information is rewarded with superior price. You know it in your own business. If I apply to you for a mortgage based on my own representations of ability to pay, you will either turn me down or charge a premium to cover the risk of the information you can't verify.

Once capital markets are able to price Home Loan Bank bonds on the basis of information disclosed under SEC standards and in the SEC format, the System should be rewarded with a better price. The Federal Home Loan Banks can borrow at a better rate, and ultimately, lower the cost of the borrowing all of you do through advances.

Indeed, you should monitor closely what advantages Fannie Mae may gain in the coming months as they go to capital markets on the basis of disclosures that exceed those of the Home Loan Banks.

Another point, a fear, I have heard is that we are interested in registering debt offerings. Let me be very clear on this point: No one – neither I nor the SEC – has any interest in registering Federal Home Loan Bank debt offerings under the '33 Act. It is not feasible. It is not on the agenda. No one is calling for it.

'33 Act registration of debt offering is not necessary because '34 Act registration – as done voluntarily by Fannie Mae and Freddie Mac – will accomplish the goal of providing public holders of System debt with additional, superior information. The SEC, too, has made it clear that they see '34 Act registration as the means to better inform investors in the Federal Home Loan Bank System.

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The other objection I hear most often – and many of you have probably heard it as well – comes from several Home Loan Banks that say, yes, of course, we agree to enhanced disclosure, but just not at the SEC. Our regulator, the Federal Housing Finance Board, knows us better and can handle the job.

My response is that we are indeed making great progress at the Finance Board at achieving the “gold standard” of regulation, but in the area of safety and soundness regulation.

Could the Finance Board serve as the disclosure agent? Sure, of course.

But Treasury, Chairman Greenspan, and Commissioner Donaldson cite SEC registration as the preferable course of action for a good reason: It’s what the SEC does. The SEC is the proven expert in financial disclosure, with the staff, expertise and commitment to do the job effectively, and thereby ensure the public and investors of the reliability and completeness of the disclosures.

In our meetings with their key staff, we have found the SEC willing to recognize and adjust for the unique nature of the Federal Home Loan Bank System. They understand that the System is a cooperative, owned by member institutions like yours. SEC registration will not require the Home Loan Banks to make any fundamental changes in how they conduct their business.

And it will not require the surrender of any of the Finance Board’s ongoing responsibility for ensuring the safety and soundness and housing-mission compliance of the System. If it did, I would never agree to it.

Enhanced disclosure, increased transparency, IS going to happen.

In the end, the evidence weighs squarely in favor of this outcome. The benefits will be greater public accountability for these government-sponsored enterprises, greater transparency in the management of Home Loan Bank affairs and control of their business risks, and greater reliance by investors on SEC filings rather than the doomsday backstop of a taxpayer bailout.

And a better deal for all of you.

I mentioned the Finance Board’s role as safety and soundness regulators. The goal of upgrading the Finance Board’s ability to oversee the System is my personal priority, and of such critical importance to all of you who are members, that I do want to focus on it for a moment this morning. We have made significant progress over the last year.

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When I became chairman 14 months ago, I determined that we could do a much better job in fulfilling our responsibilities to ensure that the System and the Banks operate in a safe and sound manner.

Our examination function was understaffed and insufficiently focused on the Banks' risk assessment processes, internal control systems, and systems of corporate governance. I immediately set out to fix those problems through new leadership and additional resources for the Office of Supervision. We reorganized the agency to streamline management and reinforce internal accountability.

Our new supervision program is now more akin to the safety and soundness supervision you know from the Office of Thrift Supervision, Office of the Comptroller of the Currency, the Fed, and the FDIC.

We brought experienced and accomplished leadership to the Office of Supervision. We conducted a national search, finding a new director and a new deputy director who between them have more than 40 years of federal bank regulatory experience.

We increased the resources available for supervision, expanding our examination staff to 15 full-time bank examiners, soon to be 18, and eventually 24. We also added professionals with extensive experience in mortgage finance and risk assessment. We are now conducting more thorough, regular examinations, and communicating the results more effectively to the Banks.

We refocused those examinations. In the past, we paid narrow attention to compliance with Finance Board regulations, rather than focusing on a Bank's risk and the quality of its risk management.

Now our examinations recognize that banking is a business of taking risks, and the responsibility of bank supervisors is to ensure that the institutions they regulate understand those risks, and that they monitor and control them through prudent risk management practices.

We started following board governance in a serious way, launching a systemwide review of how the 12 Federal Home Loan Banks are run at the board level. These reviews are now completed, and a final report on board governance in the Bank System should be ready by the end of this month.

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My philosophy, shaped by Gramm-Leach-Bliley, is that the Federal Home Loan Banks should have the freedom to operate their own businesses and pursue their own business strategies, so long as those strategies are consistent with the System's housing finance mission. The Banks' Boards of Directors – and by extension, all of you who are members – should be telling the Banks how to do business, how to earn a profit.

The Finance Board's responsibility, in turn, is to ensure that the Banks' activities are carried out in a safe and sound fashion. We are doing just that, we are doing it better than we did a year ago, and we will do it even better a year from now, and in the future.

Many of you have asked for my views on the so-called multidistrict or modernized membership issue. In the interests of time, let me cut to the basic point. As many of you know, the Finance Board has been asked to consider the issue of whether one bank can simultaneously be a member of two or more Federal Home Loan Banks. This situation normally arises when a bank in one state merges with a bank in another.

When Congress created the System 70 years ago, it anticipated that Home Loan Banks would operate where their members' collateral was located, and that meant right in their home districts. Now many member banks do business literally across the nation, and that means their collateral is not necessarily concentrated in any one region.

This very important development requires, I believe, a fresh look at single versus multidistrict memberships, and especially at the impact limiting memberships might have on the safety and soundness of individual Banks or the System.

The Board asked all 12 Banks for input on how they viewed this changing world of financial services. There were two basic points of agreement in the responses we received: First, consolidation will continue, and second, it will have some effect on the Bank System. After that, opinions go in every direction.

Our staff is now completing a study of industry trends and implications for the Banks. When it comes time to make a proposal – if facts reveal that membership rules should be modernized in some fashion, a circumstance that is certainly not a given at this point – be assured of two things.

First, any proposal coming from me will respect the cooperative structure, and regional structure, that provides unique strength for Home Loan Banks. Second, there will be ample opportunity for America's Community Bankers and other financial services industry associations to be heard.

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A year ago when speaking to you, I mentioned the possibility of Federal Home Loan Bank securitization being on the Finance Board's agenda for the coming year. At the time, several Banks informed me they were looking at the possibility at some point of considering the issuance of mortgage-backed securities.

No such proposal has come forward, and at the Finance Board, we are not at present studying the issue. In short, securitization is not on our agenda for this year.

Diane asked that I also touch on AMA products, that is, the various Acquired Member Assets programs and any changes that might be taking place, so let me do that.

Again, when it comes to Bank business decisions, I believe in deferring to the judgment of the Banks and their boards of directors, so long as safety and soundness are not jeopardized. When it comes to AMA, the Banks are clearly responding to the market.

Members institutions like and use AMA products. The Federal Home Loan Bank of Chicago's Mortgage Partnership Finance program, or MPF, had \$41.7 billion outstanding at the end of 2002. The MPP Program, another program run by three other Banks, had \$17.6 billion, and the Federal Home Loan Bank of Atlanta will begin offering MPP this year, as well.

Chicago is also developing a new product to enhance the attractiveness of AMA programs to members, a program known as Shared Funding. The Finance Board approved Shared Funding through its standard staff-level process, because this kind of program is specifically permitted – actually anticipated – by the AMA regulation the Finance Board adopted in 2000, well before my tenure.

In that regulation, the Finance Board made clear that the Federal Home Loan Banks could acquire senior tranches of mortgage financing instruments as an acquired member asset. That describes Chicago's proposal exactly. As an enhancement of its existing Mortgage Partnership Program, Chicago will buy high-quality tranches of MPF loans pooled by a member bank.

I am constrained from discussing Shared Funding in any more detail, because the first transaction has not been consummated and we are guided by confidentiality rules, but I am anticipating Chicago's announcement of the initial Shared Funding deal soon.

As I close today, allow to me say, again, how much I enjoy talking with the members of the ACB. As someone who spent most of his adult life as a local businessman, the owner of a real estate title abstracting and closing company, I greatly appreciate the central role all of you play in housing finance, and by extension, our nation's economy.

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After all, housing and its related industries represent 14 percent of our U.S. economy. We all know it's a contribution for which all of you deserve great credit, and our nation's thanks.

Several weeks ago I came across an Associated Press story, one of the unfortunately rare stories that reports good news. And the news was great. It seems that record low mortgage rates have prompted more and more young people – 20-somethings, in fact – to buy their own homes. They're probably doing business with many of you in the process.

In many cases, these young people find that paying rent for an apartment costs about the same as a monthly mortgage payment. They take pride in owning a home, and the responsibility pays off in many other ways. As one 24-year old who bought a condo in Washington, said in the story, "Now that I am in debt, I am very aware of my finances. I am also more focused on saving."

That kind of responsibility is such a positive thing for our country and its economy, a benefit that grows, in no small part, out of your work in financial services.

And I also noted the comments reported from Scott Syphax. Scott is president and CEO of the Nehemiah Corporation of California, a nonprofit organization that provides homebuyers with down payment assistance.

He also serves as a public interest director on the Board the Federal Home Loan Bank of San Francisco, a position I was pleased to nominate him for last year.

In the story, Scott comments, "Homes for these young families are not just a place for them to lay their heads at night. These are little prosperity factories."

The members of America's Community Bankers, through financing, are fueling these little prosperity factories, and not just for all these young people who are thrilled to own a home. You are fueling the prosperity for our entire country – quite simply, a better future for the people of this great nation.

Thank you for the opportunity to speak with you today. I have enjoyed my time with you, and look forward to many more conversations in the year ahead.

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